State Debt and Lease-Purchase Financing

February 9 & 10, 2016

Appropriations Committee Hearings

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Statute Requires JLBC to Annually Report on State Debt and Other Obligations

- Outstanding principal on State debt, along with principal and interest payments in the prior fiscal year (FY 2015)
- Summary of payment deferrals (“rollovers”) by budget unit and the cost of these deferrals
- Information on per-capita State debt and other long-term obligations
- A 10-year history of State debt and long-term financing based on available data

Arizona's Credit Rating Was Upgraded in May 2015

- In May 2015, both major credit rating agencies upgraded AZ's credit rating (S&P: AA- to AA; Moody's: Aa3 to Aa2)
  - Outlook from both agencies is stable

- In comparison to other states, 30 states have a higher rating, 11 states have a similar rating, and 8 states have a lower rating or are not rated due to a lack of state level debt

Debt Balance and Payment Information

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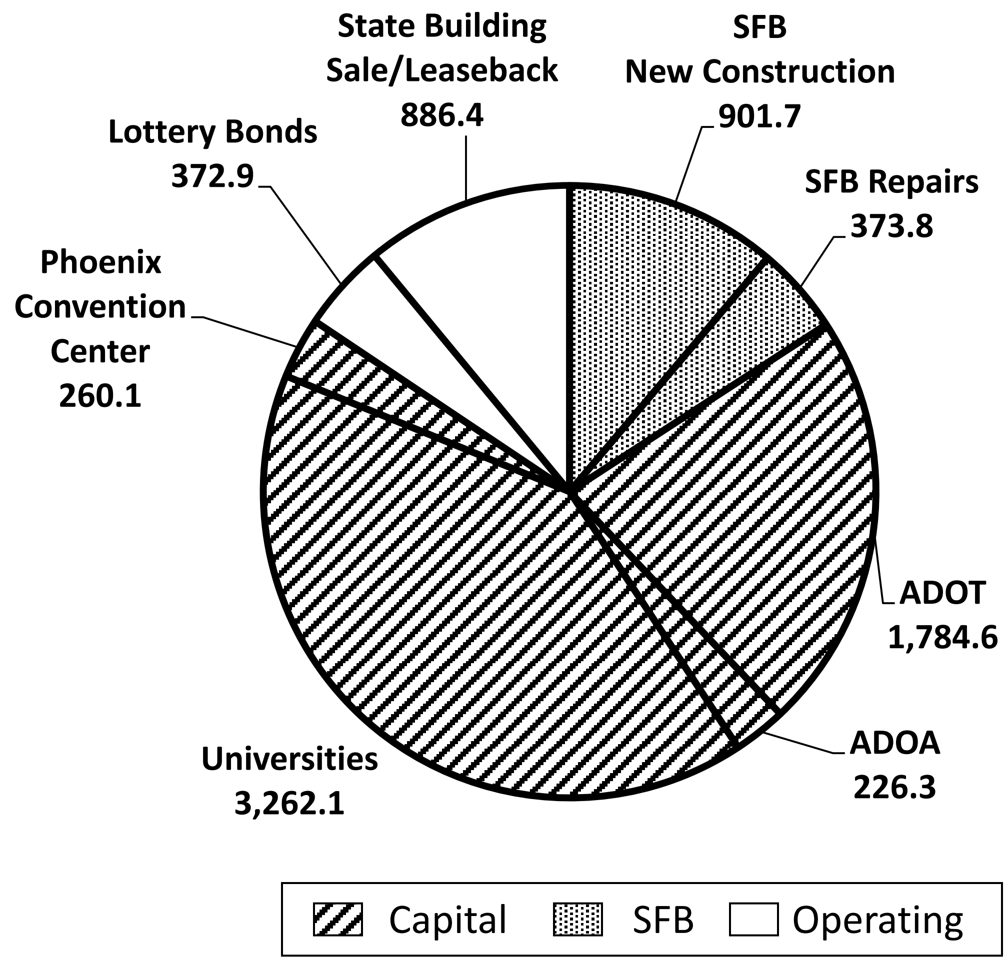
Total Outstanding State Debt/Lease-Purchase Financing is $8.1 Billion
- Reflects Multiple Payment Sources

Outstanding Balances

Capital Facilities/Uses	$ 5.5 B
School Facilities Board	$ 1.3 B
Operating	$ 1.3 B



End of FY 2015 - $ in Millions

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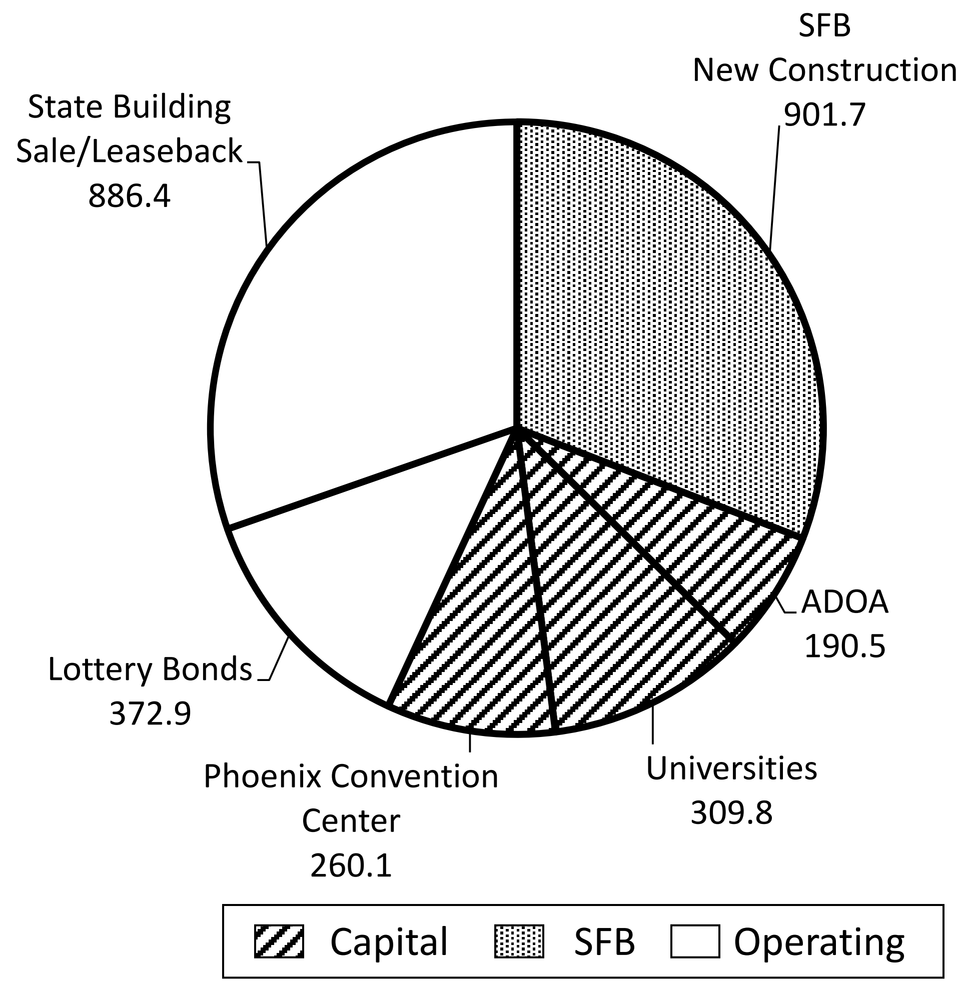
General Fund Share of Outstanding Balances Is $2.9 B

Outstanding Balances	
Capital Facilities/Uses	$ 0.7 B
School Facilities Board	$ 0.9 B
Operating	$ 1.3 B



End of FY 2015 - $ in Millions

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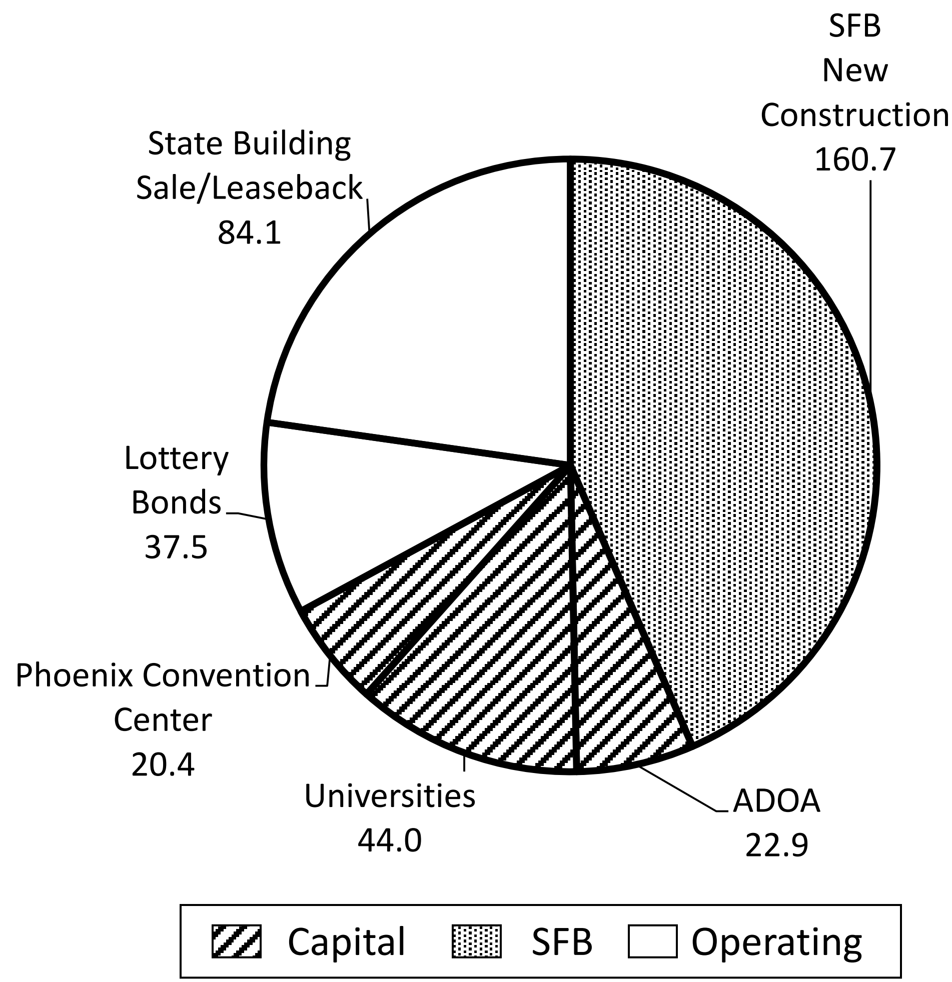
General Fund Debt Service Cost $370 M
- Represented 6th Largest Budget Unit

Annual Payments

Capital Facilities/Uses	$ 87 M
School Facilities Board	$ 161 M
Operating	$ 122 M



FY 2015 - $ in Millions

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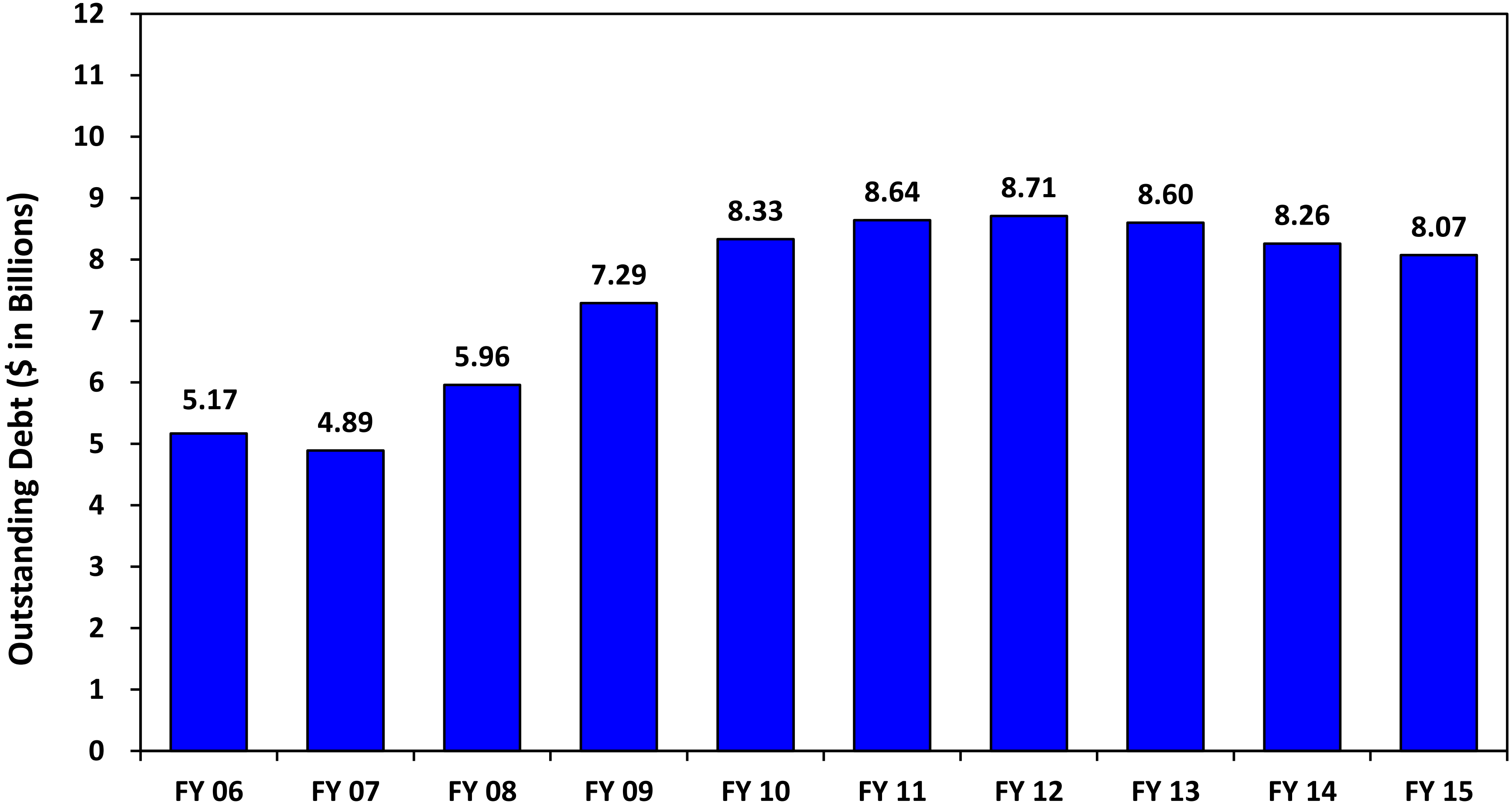
Arizona Overall Debt Obligations Have Increased Since FY '06, But Improved Recently

- Increase Is Mostly Due to Universities, SFB and Operating Financing



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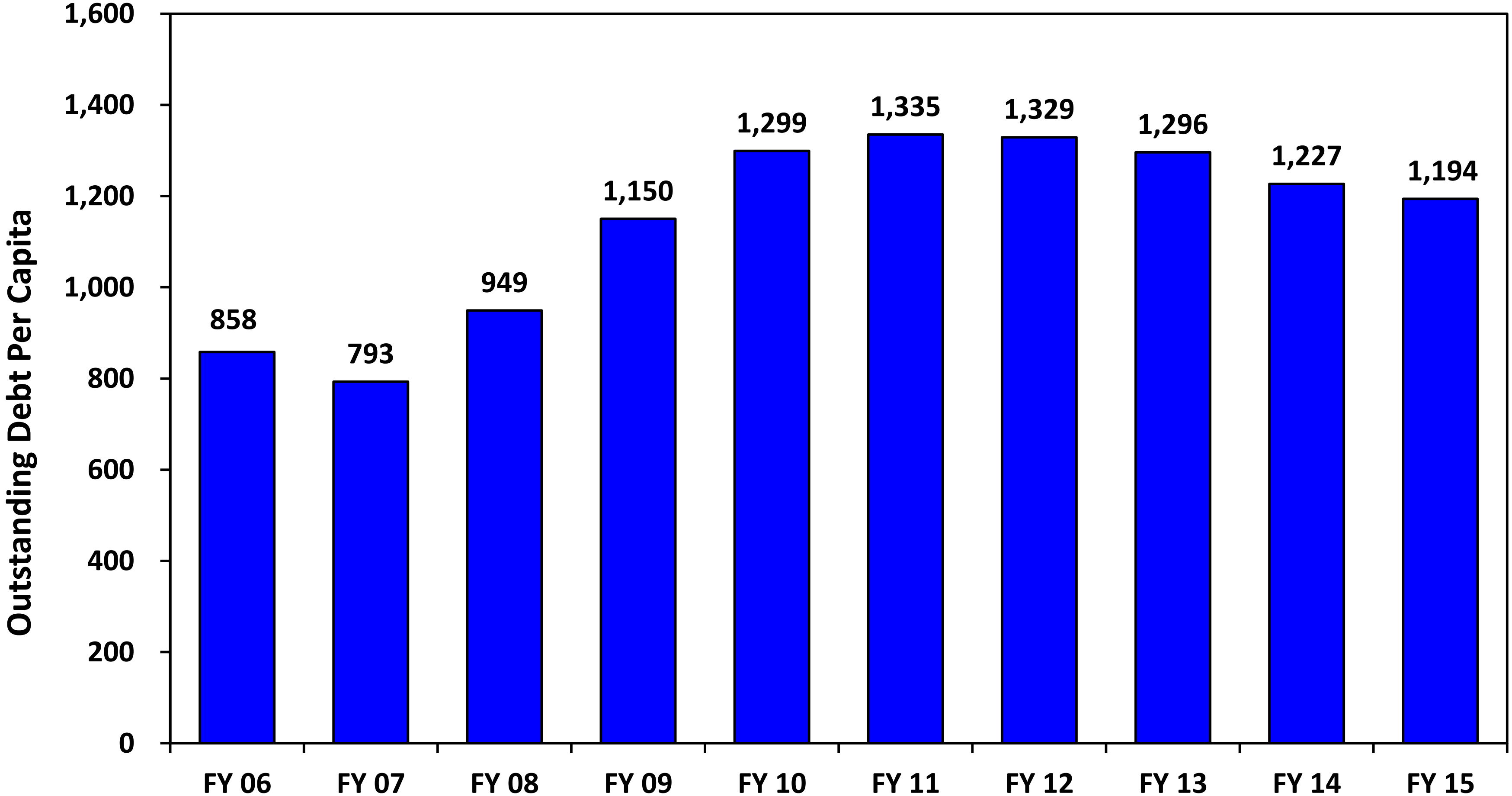
Arizona Per Capita Debt Obligations Since FY ’06
- State’s Assumption of Financing K-12 Construction and Operating Financing Played A Major Role In Growth



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State Also Defers $1.2 B of Payments Annually
- Interest Is Not Paid By the State For Rollovers

- K-12 State Aid payments: $931 M (excludes small districts)
- Universities: $200 M
- DES: $21 M
- DCS: $11 M (Executive Budget proposes to eliminate)

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Potential FY 2017 Budget Issues

Annual General Fund Debt Service/Lease-Purchase Financing Costs Will Be Stable Through FY 2017

	$ in Millions		
	FY ’15	**FY ‘16**	**FY ‘17**
Capital Facilities/Uses	87	71	75
School Facilities Board	161	172	170
Operating	122	122	122
Total	**$370 M**	**$365 M**	**$367 M**

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Debt Retirement

- Given State's large cash balance and limited structural balance, debt retirement is a potential source of one-time spending
- Annual report from ADOA on debt retirement options
  - 2015 Report estimates $100 M debt retirement generates future debt service savings of $46 M through FY 2030.
- State financing contains call provisions – where the state is prohibited from paying off an outstanding debt, typically 10 years from issuance
- However, State still able to retire debt through "defeasance" process – payoff placed into escrow account until call date and the debt is removed immediately from the state's book

Public School Credit Enhancement Program

- Executive Budget would create program in the new Governor's Office of Education
- Program would set aside funding to serve as insurance for district and charter school debt financing in case of default
- This reserve balance would come from 2 sources:
  - $20 M transferred from FY 2016 Access Our Best Public Schools appropriation originally made to SFB
  - $80 M of the State's existing operating balance

Credit Enhancement Program - Construction

- Executive estimates that program will serve as insurance for $300 M – $400 M of new school construction loans
- At that level of borrowing, Executive assumes program will help fund the construction of 35 new schools
  - Cost per school would range from $8 M to $11 M
- Some recent School Facilities Board new construction projects in this cost range
  - K-8 School – Avg. 65,000 Sq. ft @ $138 = $9 M per school
  - 9-12 School – Avg. 140,000 Sq. ft @ $167 = $23 M per school

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Credit Enhancement Program - Financing

- Credit Enhancement Program is designed to increase credit rating, lowering issuer interest rate and debt service costs
- Large Metro Phoenix school districts have up to AA bond rating
- Current charter school credit rating is typically around BB – program may improve charters to district levels
- Program could reduce annual debt service payments for a given charter school loan by $100k - $200k

Credit Enhancement Program - Questions

- Application/Approval process
  - Specific financial criteria
  - Non-financial criteria (academic performance, years of operation)
- Fees/Premiums paid by schools enrolled in program
- Historical data on charter school defaults to measure potential risk of program
- Would existing school loans be able to refinance under program, or limit to new construction
- Analysis of program demand
- Any legal issues – Gift Clause

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